HARVARD
LAW REVIEW.

VOL. X. OCTOBER 26, 1896. NO. 3.

NEW-FASHIONED RECEIVERSHIPS.

IN the course of the growth of "that system of justice which was administered by the High Court of Chancery in England in the exercise of its extraordinary jurisdiction," [1] commonly called Equity, a system adopted in this country, and substantially, if not in form, in all our States, and covering three broad heads of jurisdiction, — equitable titles, equitable rights, and equitable remedies, — we find, under the last title, the preventive remedy of the appointment of receivers, in close category with bills *quia timet* and writs of *ne exeat* and of *supplicavit*.[2]

It is one of the very oldest remedies in the Court of Chancery. The jurisdiction is perfectly familiar and altogether unquestioned.

An approved definition of a receiver is this: An indifferent person between the parties, appointed by the court to collect and receive the rents, issues, and profits of land, or the produce of real estate, or other things in question, pending the suit, which it does not seem reasonable to the court that either party should do, or where a party is incompetent to do so, as in the case of an infant.[3]

The rhetoric of this definition certainly leaves much to be desired, but we may not look for better, to our professional discredit it must be said. The definition is gleaned and made up from many sources, and may be said to be accepted, if not entirely exhaustive. In addition, the receiver is not the agent or representative of either

[1] Bispham, Princ. of Eq., 1. [2] *Ibid.*, 51. [3] *Ibid.*, 51.

or any party, of either defendant or plaintiff, or of any one of many plaintiffs or defendants. He is the officer of the court, its executive hand. The appointment and choice of the receiver resting in the discretion of the court — the sound but personal rather than judicial discretion — are to be made in the interest of all parties or persons concerned or interested in any actual or legal sense.

Naturally and inevitably, with the rise and growth of corporations, receiverships were extended to them, and, chiefly within the last thirty years, railway corporations have not only been subjected to this remedy, but railway receiverships have become by far the most important feature of this branch of equity, especially in the courts of the United States. This application to railways presents some peculiar features. Railways being *quasi* public corporations, — a feature greatly enlarged by our courts within the last dozen or twenty years, — and their business being peculiar and virtually monopolistic, the possession of railways by courts of necessity involves far more than the collection of rents and incomes of lands or the produce of real estate; it involves the management of an intricate, technical, highly specialized business, and the operation of special, and often vast, mechanism and mechanical instruments and appliances. Owing also to the fact that railways are almost always covered by mortgages of differing ranks and kinds, the holders of the mortgage bonds being numerous and widely scattered, the direct pecuniary interests to be affected and served by a receiver of a railway are of the highest and widest importance and interest. The proper result of these and such considerations might well seem to be a high degree of caution and reluctance on the part of courts and judges in appointing railway receivers. Such is the theory, often announced and repeated by courts; but the fact is, as all must concede, that in later days very little heed has been given to this theory, and suitors have asked for and courts have granted the remedy of receivers with a readiness, not to say zeal, which would once have been regarded as scandalous. Not seldom a race has been run between State and Federal courts, and between different State or Federal courts, for possession by receivers of railway properties.

In the definition of a receiver which has been presented must be marked several conditions of the appointment which should be kept in mind. Some of them are these: (1) an indifferent person is to be selected; (2) he is to be the mere hand and agent of the court; (3) he is to be appointed and to hold *pendente lite*; (4) the inter-

ests of creditors, of those whose money has been lent or invested in the property, are the primary interests. These might have been called until recently invariable, and in all but the technical sense jurisdictional, conditions and requirements, especially the condition of a suit pending. And by suit pending was invariably meant a suit between a complainant having some real, direct, individual or official interest which he sought to protect, and the corporation or party which had failed of its legal obligation or duty; for example, a judgment creditor who had exhausted the ordinary means of enforcing his claim, or a holder or holders of bonds secured by a mortgage lien, which the defendant corporation had failed to honor according to the terms of the bond and mortgage, or a trustee or trustees representing the whole body of such bondholders. The suit must of course have been *bona fide* in all respects, and it has been expressly laid down by approved authorities that the conduct of the party applying for a receiver would be looked into by the court, and the court would refuse the relief if the party applying did not show himself free of neglect, collusion, unfair combination, or other legal impropriety;[1] in other words, of legal phrase, did not show clean hands. Courts, and especially judges, differ in judicial manners and methods; but it may be said that the former judicial standard in these respects frowned upon and made highly impolitic any haste, over zeal, or obvious sinister ardor, in seeking the appointment of receivers. The remedy was then regarded as essentially high-handed and extreme, — the absolute wresting away from the hands of its owners of property of such peculiar character, and often of such enormous value; and taking it, to be managed as well as held, by a court through its receiver.

It can hardly be questioned that new ways have come in, and new rules of judicial conduct have obtained vogue, and apparently new principles or conditions of appointment of receivers have been adopted. We do not care to dwell here upon all the considerations which supported what we call the old and conservative view of this point, nor upon all the steps by which a great change has gradually come about. It is enough for our present purpose to direct attention, as we have now done, to what all who are informed know to be a fact.

What we purpose is to notice briefly one startling departure in this regard, — the appointment of receivers of railway companies on

[1] Kerr on Rec., 10.

the application of the companies themselves in advance of any default upon mortgage obligations, and without the presence of other conditions once regarded as essential for the appointment of receivers.

The first important instance of this kind was the well known Wabash case in 1884. The significant and peculiar facts of this case were substantially these. The Wabash railway, being a line consolidated of several originally separate roads, and embracing several thousands of miles of railway, was covered not only by separate mortgages on the separate properties of the original line, but by general mortgages on divisions of the road as they were from time to time organized in the process of growth and consolidation, and finally by a huge general mortgage on the whole consolidated road. A few days in advance of the date of payment of a semi-annual coupon for interest on the bonds secured by the last named mortgage, the Wabash company filed its bill in the United States Circuit Court at St. Louis, averring its inability to pay its next due coupon, and its insolvency; and asking for the appointment of receivers, mainly on the ground that without this remedy the property would be disintegrated. No notice of the application for receivers was given to any bondholders, but only at most to the trustees of the general mortgage. Upon the unopposed motion of the Wabash company, receivers were appointed, who took instant possession of all the properties.[1]

It is clear there was here no suit pending, in the sense of the definition already quoted. No relief nor protection was sought by any creditor of the company; no suit was begun by any creditor. The proceeding, so far as it resembled any former proceeding or type of legal proceedings, resembled most an application in voluntary bankruptcy. It could not have been this, because no bankrupt law was then in existence. It was manifestly without precedent, or "peculiar," as was said by the District Judge who administered the case to a great extent: "The case is peculiar in this aspect, that the application was made by the corporation itself, instead of being made by the mortgagee on default of payment of interest."[2] In point of fact, other requirements and conditions for the appointment of receivers, as stated in our definition, were not observed in this case. (1) The receivers appointed were not indifferent persons,

[1] Up to this point there is no report of this case, the receivers having been appointed at chambers, and no opinion having been given.

[2] Judge Treat, in Wabash, &c. *v.* Central Tr. Co., 22 Fed. Rep. 272.

one being closely connected with the former management of the railway as well as deeply interested in it pecuniarily, and bound up in interest with its chief financial promoters and managers, and the other occupying relations hardly less free from objection. (2) The interests of creditors could not have been made the primary consideration in the appointment of receivers, because they were not advised of the application, though the trustees of the latest general mortgage were in point of form advised, but they did not extend the notice to bondholders; and because the persons appointed were not representative of the wishes or interests of the lien creditors of the road, but the friends and choice of those who had managed the road.

It will, therefore, be seen how completely the ordinary conditions were here disregarded. It was plainly the opening of a new chapter. There had previously been one proceeding similar in some respects to the Wabash case in the United States District Court for Connecticut, but only one, and that not a close nor conspicuous precedent.[1]

In 1886, the Circuit Court of the United States for the District of Illinois removed the original Wabash receivers from their position as receivers of the lines of railway belonging to the system east of the Mississippi River, and appointed a new receiver for those lines.[2] In the course of the opinion of the court in this case, it was remarked: —

"It has frequently been deemed necessary, in suits against insolvent railway corporations, to foreclose mortgages, to appoint receivers to operate and protect the property, pending the litigation; but it is unusual and novel, to say the least, to entertain a bill filed *by* such a corporation against its creditors, and at once, without notice, place the property in the hands of one or more of the directors whose management has been unsuccessful. Receivers should be impartial between the parties in interest; and stockholders and directors of insolvent corporations should not be appointed, unless the case is exceptional and urgent, and then only on the consent of parties whose interests are to be intrusted to their charge."

Upon the application of the receiver appointed by the Circuit Court in Illinois for possession of the lines east of the Mississippi

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[1] See, especially, remarks of Judge Treat, in 29 Fed. Rep. 623 *et seq.* No decision of the Supreme Court is named by him, and it is believed there is none.

[2] Atkins *et al. v.* Wab. St. L. & P. Ry. Co. *et al.*, 29 Fed. Rep. 161.

River, the District Judge of Missouri entered upon a defence of the action of the court in the original appointment of the Wabash receivers.[1] The court said: —

"It was an application by the corporation itself, concerning which a great deal of comment has been made elsewhere. . . . Here was a vast system, extending through many States and many judicial districts. A default, it was certain, would be made in a few days. What should be done? The interests of all concerned required that some judicial action should be had for the conservation of those interests, — stockholders, bondholders, creditors at large," etc. (pp. 623, 624.)

Again the court said: —

"The simple proposition submitted to the court was this. Here is a vast property, in a bankrupt condition, — whether through mismanagement or otherwise was immaterial to this court. Connected with that property were the rights of stockholders and general bondholders, bondholders under underlying mortgages, general creditors, and, further than that, the duties of these corporations to the public at large, and to the State which granted them their franchises. . . . Their primary obligation was to the sovereign who granted them the franchise. They undertook, *first*, to pay their dues to the government, in the nature of taxes; *second*, they undertook to run a safe operating road, — safe to life and to the transportation of property. Did they do it? Suppose they cannot do it. Then they fall within the judicial administration to compel them to do the best they can. That is all there is in that branch of the inquiry." (p. 625.)

Is not the answer to all this obvious and conclusive, — that it is no part of the duty of courts to protect interests of creditors or of any other persons or parties, or to enforce duties to the State or the public, except upon due and proper application of the parties or the State, made according to the orderly and established modes of legal and judicial procedure? Has a court any more concern than a private individual with the interests of parties or of the State, until such interests are duly presented by the proper parties? Such questions seem to answer themselves. The creditors — stockholders, bondholders, creditors at large, the State or the public — were in no manner before the court when the Wabash receivers were first appointed. If a court may of its own motion assume to represent and act for parties not before it, it is not easy to fix any

[1] Judge Treat, in Cent. Tr. Co. *v.* Wab. St. L. & P. Ry. Co., 29 Fed. Rep. 618.

limits to its activities or powers. Is not the vista opened by such claims plainly unbounded, as well as portentous? Who could wish to see it entered upon? No conception of judicial duty is more necessary or elementary and fundamental than that the court must await the coming of the proper suitor before exercising its powers. What proper suitor for redress or protection to the property interests of creditors, or to the interests of the State, was before the court when these receivers were appointed? Only the debtor, the defaulting, delinquent corporation, was before the court. Once for all, be it said, courts have no function except to sit still until they are moved by parties having legal rights to assert before them.

This case has been characterized by the most recent authority upon the subject of receivers as follows: —

"It is not only utterly at variance with some of the elementary rules relating to receivers, — as that they can only be appointed in a suit pending, and for the sole purpose of preserving the property in controversy, to await the judicial determination of its ownership and disposition, etc., — but, in its most favorable aspect, it makes receivers mere assignees for the benefit of creditors. That it opens the door to gross frauds upon creditors, by enabling unscrupulous manipulators of railroad property to use the power of the United States courts to stay the hands of creditors in pursuing their lawful remedies, and to carry on the business of the road while schemers force favorable compromises, is manifest. That the discretion of a single judge, however honest and capable, may be successfully invoked, upon the application of an insolvent railroad company, to take possession of its property and operate it for an indefinite period of time, under a system which gives the court control of suits against the company even beyond its own territorial jurisdiction, and suspends the common law right to a jury trial, is startling. It is to be hoped that this decision will not become a precedent." [1]

The same authority also remarks: —

"The appointment of a receiver upon an *ex parte* application before the bill is filed is error, and will be revoked upon appeal, without further considering the merits of the application." [2]

Since the Wabash case, many like cases have arisen; and it may now be said that the practice is well established; indeed, that under like circumstances it is the almost invariable practice. By this is meant precisely, that when a railway company is in financial straits,

[1] Beach on Receivers, sec. 327.

[2] *Ibid.*, sec. 106.

or about to be in a case where under the former practice its creditors would be entitled to bring suit to subject its property to a sale for the payment of its debts, and, pending such suit, to ask the appointment of a receiver, the recent practice is for the company itself to anticipate the occurrence of such conditions, and, as the creditors cannot move till they do occur, to seek the court in advance of default, file a petition or bill on its own behalf, and ask the appointment of receivers, usually of its own selection, and almost invariably those most deeply implicated in the past management of the company. We do not recall any important railway recently placed in the hands of a receiver in which this course was not followed; especially our large systems, such as the Atchison and Sante Fé, and the Baltimore and Ohio. In nearly all these cases, if not in all, the former officers, or others intimately concerned in the former management, were chosen as receivers; and, in all cases, those selected in the first instance by the company itself. It cannot yet be said that the practice has received the approval of our highest court. In the litigation of a collateral issue, arising out of the main Wabash case, the Supreme Court of the United States, alluding to the charge of one of the counsel that the bill in the Wabash case was "without precedent," said, "We are not called upon to inquire as to how that may be."[1] But it is certainly true that the practice is actually followed, so far as we know, in nearly all the courts of the United States, as occasions arise.

Some of the results of this practice ought to be noticed, at least in the spirit of inquiry and study. The foremost result, and beyond doubt the result primarily aimed at by this practice, is the keeping of the control of the property and the virtual continuation of the management, in the hands of those who presumably in all cases, and in most cases actually, have brought on the necessity of the receivership. This is certainly a result which calls for a little reflection. In former days such a result was regarded as one to be sedulously avoided. Thus, a distinguished judge used the following language on the occasion of a much pressed motion to appoint as receiver the vice-president of the defaulting railway company, a man of unquestioned integrity and ability: —

"It appeared to the court then, and it does now, that the Chesapeake and Ohio Railroad Company is overwhelmed with debt, secured and un-

[1] Quincy, &c. R. R. Co. *v.* Humphreys, 145 U. S. 82, 95. See, however, Beach on Rec. sec. 327, note (1).

secured. How it became so, it is not for us to determine. But the court, when called upon to appoint a receiver for a corporation totally insolvent, who is to be the mere servant of the court, upon whose fidelity and ability to manage during the pendency of the suit the property intrusted to him the court must rely, ought not, and ought not to be expected, to appoint a person under whose charge and control the resources of the road had been exhausted and its property seized on execution, and the necessity for a receiver brought about.

"The receiver is not the receiver of the bondholders or secured creditors. He is the mere hand of the court. The unsecured creditors, whose chances of a dividend are remote, have a deep interest in knowing the road, while its assets are being marshalled and its creditors, their claims and priorities, ascertained, is free from the control of those whose administration of its affairs ended in bankruptcy." [1]

This example has remained controlling in that circuit, and more recently the same judge said in a similar case, "Unless in cases of imperative necessity, no person will be appointed receiver of a railroad company who is a party to, or of counsel in, the cause, or who has been an officer in, or an official of, the insolvent company." [2] More recently in the same jurisdiction the eminent and very learned successor of the judge just referred to said, "Under the rule adopted in this court, after careful consideration, this makes him [the proposed receiver] ineligible for the appointment of permanent receiver. The whole question was discussed in Finance Co. *v.* Charleston, C. & C. R. Co., 45 Fed. Rep. 436, and for this reason alone, against the prejudice of both judges then sitting, Mr. Lord was not continued as receiver. See also Phinizy *v.* Augusta & K. Ry. Co. (decided at this term), 56 Fed. Rep. 273." [3]

If it is said that courts have it in their power to prevent such a result, the answer is that courts do not, in most cases, prevent it. The essential impropriety and injustice of appointing the former heads and managers of railroads as receivers need not be argued. If there has been mismanagement, such receivers will be interested in covering it up; if there has been favoritism, or any one of a hundred faults of management, such receivers will be likely, if not certain, to continue it. It would seem to be the right of creditors who are in jeopardy, not only to initiate proceedings for the ap-

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[1] Judge Hugh L. Bond, in Richards *v.* Chesapeake, &c. R. R. Co., 1 Hughes, 28.

[2] Finance Co. *v.* C. C. & C. R. R. Co, 45 Fed. Rep. 436.

[3] Judge C. H. Simonton, in State Tr. Co. *v.* Nat. Ld., &c. Co. *et al.*, 72 Fed. Rep. 575.

pointment of receivers, but to have the most potent voice in their selection.

But perhaps the gravest question presented is of the legal or judicial wisdom and correctness of allowing an insolvent railroad company, in the absence of a bankrupt law applicable to such cases, voluntarily and against the known and obvious judgment and interests, as is often the case, of the creditors, to transfer the property which was given to secure creditors, and legally belongs to them, into the hands of courts. Interests of creditors may be conflicting; they often or generally are; but is it, under any admissible view, the right of the debtor to put the mortgaged property out of his hands, even into the hands of the court, on his own motion and with no reference to the views of creditors? If we could be certain that courts would see that no undue control of the property was thus obtained, we might still dispute the right; but when we see it resulting in injustice and open scandal, can it be doubtful whether or not the practice is a good or safe practice?

The chief argument or defence of the practice in question offered by courts or railway corporations — the chief ground set up in the bill in the Wabash case — is the belief or fear that, if the courts do not seize the properties before default, that is, before the creditors can move, the system or consolidation of lines will be disintegrated, and great loss will thence arise. The first and obvious comment on this is that it would seem to be the concern of the creditors rather than that of the corporation or the courts. The suggestion would appear to be, in fact, a mere pretence, intended to cover designs having no reference to the welfare of creditors.

But if it be true, in such case, that loss will ensue from disintegration, — a matter always open to question, — why not leave the decision as well as its consequences to the creditors? Do railway creditors need tutelage at the hands of the debtor and delinquent company? Are they not generally of a class and character supposed to be rather well fitted and able to care for their own interests? Why not let the default come, if come it must, and leave it unreservedly to those whose interests are largest, and most directly involved, to seek the courts, if they think best, or to keep out of the courts, if they so prefer? Does not the present practice take away their right to freedom of action and judgment in the premises? We merely advance, without answering here, these queries.

The familiar maxim that makes the enlargement of his jurisdic-

tion a mark of a good judge will hardly cover this extension of jurisdiction over such vast interests at the sole instance of the debtor. To amplify is not to seize without due regard to established legal practice, or the sound and usual conditions heretofore regarded as essential. The wishes and views of failing debtors are not good guides for judicial action. As between debtors and creditors under railway mortgages, would not the sound rule for courts be to leave the question of the disposition and handling of the mortgaged properties to be settled outside of courts, as a purely business problem, rather than to allow the debtor to dispose of the pledge before the creditor can exercise any choice or adopt any active policy? In other words, is not the recent practice here discussed as far lacking in soundness of principle as it is fruitful in undesirable results?

It has sometimes been said, on the other hand, that if the debtor company and the creditors both unite in the application for receivers before default, all objection is removed. In such case, on the contrary, does not the chief and fundamental objection remain, namely, that courts of equity have no proper jurisdiction to deal with property or property interests in this summary and sweeping way except when a case of actual default has arisen which gives the right to creditors under the terms of the mortgage to proceed to enforce their remedies as they may themselves be advised at that time? An ordinary railway mortgage expresses the remedies available to the creditors or bondholders, as well as the rights reserved to the debtor. In view of such an express, carefully and mutually guarded contract, is it wise or just or proper, in a legal sense, for courts to do more than aid, as they may be called upon by those asking for such remedies or asserting such rights, in enforcing the contract of the parties? Is the plea of threatened injury, even to all interests, by delaying till default, a good one? Might not courts respond to such applications more safely, and with better results, by reminding both debtor and creditor of the fact of their own free, written contract, and there leave them? Is not any other course open to pretty certain abuse?

D. H. Chamberlain.

NEW YORK, 1896.